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SUBJECT: NIGERIA: PROBLEMS IN NIGERIAN CAPITAL MARKET OUTWEIGH
CONCERNS FOR IMPACT OF GLOBAL FINANCIAL CRISIS

Ref: A) Lagos 401
B) Lagos 353
C) Abuja 1735
D) Lagos 290
E) Lagos 266
F) Lagos 97
G) Lagos 95

¶1. (SBU) Summary: Financial analysts disagree on the effect of the global financial crisis on Nigeria, basing their argument on the perceived degrees of linkage between the Nigerian market and the global market. The Federal Government (FG) has mostly taken a laissez faire posture, contending that Nigeria is mostly immune from the global crisis. The Local commercial banks are facing credit facilities recall and credit line reductions, and the Central Bank of Nigeria (CBN) has adopted a series of small measures to ensure liquidity in the market. Falling oil prices, coupled with the global credit crunch, might hamper current operation and future investment in the oil and gas sector. Analysts denounce policy proposals introduced by the Nigerian Stock Exchange (NSE) as ill-conceived maneuvers to restore confidence in the market while the FG has been silent on the impact. Considering the multiple challenges the FG faces, the potential for steep economic downturn will severely challenge the abilities of the FG to react. End Summary.

Effect Depends on Degree of Linkage with Foreign Markets

¶2. (SBU) The impact of the global financial crisis on the Nigerian market is still under heated debate. The prevailing position is that Nigeria will not be as hard-hit as other emerging markets as a result of the low level of foreign funds in Nigeria's financial markets. Reportedly hedge funds and international portfolio investments only account for about 8 to 10 percent of the liquidity in the market. Moreover, Nigeria's foreign exchange reserves, estimated at USD 63 billion, are large enough to mitigate the impact of investment outflows through the sales of foreign exchange, some financial experts argued. Dollar inflows from the sale of oil could also help in propping up the local currency. The Central Bank of Nigeria (CBN) had introduced a series of measures to ensure liquidity in the capital market, including a reduction in the

Monetary Policy Rates (MPR) from 10.25 to 9.75 percent, a reduction in the Cash Reserve Ratio (CRR) for banks from 4 to 2 percent, and a reduction in liquidity ratio from 40 to 30 percent. The CBN predicts that these measures will inject about Naira 1 trillion (USD 8.5 billion) into the market.

¶3. (SBU) However, Bismarck Rewane, Managing Director of Financial Derivatives, argued on October 7 that Nigeria is much more integrated in the global financial market and, hence, vulnerable to the current financial turmoil. According to Rewane, the Nigerian stock market is highly stratified and segmented with 35 percent of market capitalization tradable while the other 65 percent is tightly held. Since foreign funds account for 10 of the 35 percent of tradable market capital, a drying up of capital in the international market would greatly reduce Nigeria's ability to raise capital. With respect to the CBN's measures Rewane said the liquidity injection could be inflationary.

Federal Government Unconcerned

¶4. (SBU) The FG has been fairly optimistic with respect to the potential economic impacts arising from the financial crisis, falling oil prices, and downturn in the Nigerian stock market. CBN Governor Soludo, Minister of Finance Usman, and the President's Chief Economic Advisor (CEA) Yakubu have repeatedly told the media that Nigeria is unlikely to be affected. At the October 21 Senate hearings on the potential impact of the global financial crisis on Nigeria's economy, Soludo argued that the CBN's adoption of various policy measures, including bank recapitalization and restriction on the foreign ownership of local banks, had made the Nigerian banking system strong and, therefore, shielded the economy from the global

financial crisis. He also insisted that no Nigerian bank will be allowed to fail, but emphasized that another round of recapitalization is needed to further strengthen the sector. At the same hearing Minister of Finance Usman said that while there is no crisis in Nigeria, the economy is not immune because the crisis is leading to less demand for petroleum which may have a serious impact on the budget. He also asserted that the fundamentals of the economy are very strong. CEA Yakubu told the Senate that it is possible that direct investment will evaporate in Nigeria. Financial Derivatives' Bismarck Rewane speculated that the FG's laissez faire attitude could be attributed to a vested interest among certain Northern elites to redress an imbalance in the distribution of economic wealth and power between the north and south by allowing the fall of the commercial power base in the south. (reftel D) (Comment: Some banking and financial interlocutors do share this particular viewpoint. The concentration of the NSE and bank head offices and branches in Lagos does reflect the imbalance and might lend some credence to this speculation. End Comment)

Rising Interest Rates, Credit Facilities
Recall and Reduction for Nigerian Banks

¶5. (SBU) Abubakar Bello, General Manager of Guaranty Trust Bank, told EconOffs October 15 that local commercial banks are staggering under the burden of recall of their credit facilities and reduction of their credit lines. Rewane also said banks are now funding trade lines from domestic credit mobilization, which is pushing interest rates even higher. To make matters worse, Danladi Verheijen, Co-Founder of Verod Capital Ltd., told EconOff October 14 that commercial banks have grossly inflated, if not manipulated, their earnings on paper, and in reality banks have very little capital to lend out. The convergence of rising interest rates and tightening liquidity in the domestic and international market will most likely lead to an economic slow down, he argued.

Falling Oil Prices May Hamper Energy Investments
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¶6. (SBU) Tightening credit markets and falling oil prices could hamper current oil and gas operations and threaten future investment in the sector. While international oil companies are increasingly

turning to local sources of funds to finance new projects, most funds still come from international banks or internal oil company cash flows. As a result, a credit crunch could severely limit companies' ability to fund investment in long term projects. Falling oil prices also make these investments, always risky in Nigeria, less attractive. Additionally, as noted by Adewale Shasanyan, Business and Policy Analyst of BP Nigeria on October 16, lower oil prices could negatively impact the oil and gas joint ventures that the state oil company has with international oil companies. These joint ventures rely heavily on GON funding. Even when oil prices were at record highs, the GON has been increasingly unwilling to fund its share of the costs, forcing the international oil companies to arrange loans to fund the shortfall. Falling oil prices will further exacerbate the GON's reluctance at the same time oil company coffers are tightening, which could lead to deferred maintenance on aging oil fields. Deep offshore oil fields, which are newer and do not rely on GON funding, are not as susceptible to this problem.

One Year Out, a Real Estate Bust

¶7. (SBU) The financial crisis could lead to a bust in the real estate market in 2009, Rewane projected. The recent downturn in the stock market had further fueled the real estate market bubble in Lagos and immediately surrounding areas because investors sold stocks and bought real estate (reftel A). The economic slow down resulting from the financial crisis could lead to increasing delinquency on rent payments, increasing vacancy rates, and ultimately a bust in the real estate bubble, he predicted.

NSE Proposes Banks as Market Makers in Bailout Plan

¶8. (U) On October 7, the media reported that the Nigerian Stock Exchange had entered into an agreement with six local commercial banks to provide a Naira 600 billion (USD 5 billion) "bail-out" plan for the stock market. Under this arrangement, the six banks would serve as market makers, each providing about Naira 100 billion (USD 85 million) to buy up to 15 percent of its shares from the stock market. (Note: Market makers' primary function is to stabilize the market by ensuring continuous liquidity through the synchronization of buying and selling transactions. End Note) The Nigerian Securities and Exchange Commission (SEC), however, responded that it had not granted market making licenses to any banks or business entities.

¶9. (SBU) Interlocutors decried the NSE's attempt to enlist banks as market makers as a hoax, or at best an ill-conceived plan, to restore confidence in the market. Professor Doyin Salami of the Lagos Business School said if the banks agree to the proposal, the transactions would constitute share buy-backs and not market makings because bank shares account for 60 percent of the stock market capitalization. Verheijen and Rewane said bank shareholders would not allow their banks to become market makers because banks would effectively purchase low or under-valued shares on the stock market thereby wiping out shareholder profits. This is not the role of a commercial bank, the two analysts contended. From Guaranty Trust Bank's perspective, Abubakar Bello said the government needs to "sweeten" the deal with incentives, for instance tax exemptions or guaranteed rates of return, in order for banks to consider it. Interlocutors contended that the premature announcement of this agreement was a maneuver on the part of the NSE to boost market confidence.

NSE Leadership Questioned

¶10. (SBU) Industry experts are concerned with the FG's relative complacency towards the performance of Dr. Ndi Okereke-Onyiuke, Director General (DG) of the NSE. There has been a growing and resounding call within the private sector for the resignation or removal of the NSE's DG given her alleged tinkering with and manipulation of the stock market (reftel B). Verheijen emphasized

that the NSE, through its actions, had demonstrated a willingness to protect issuers instead of investors and was, therefore, severely compromised. According to interlocutors, the NSE's leadership needs to change; however, analysts noted it is unlikely the DG will resign because she has deep and strong ties to political and business elites who have thrived during her tenure of the stock market.

¶11. (SBU) Comment: The Nigerian stock market and banking sector are under scrutiny by international investors and financial experts because of irregularities in their practice and because of questionable fundamentals (reftel B, C, D). The stock market does not effectively operate on market principles, and some local banks have major holes on their balance sheets. Given existing problems in the domestic market, it will be difficult for the FG to contain the impacts of the global financial crisis, which then will lead to a downturn in Nigeria's economy. In the best case scenario, the global credit crisis might be a blessing in disguise as it exposes the problems facing the Nigerian financial market and regulatory structure. In the worst case scenario, it will magnify the problems, and challenge the FG's interest or ability to react. End Comment.

¶12. (U) This cable has been cleared with Embassy Abuja.

BLAIR